

The Tax Law on Exempt Organizations: What Every LITC Needs to Know

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Section 501(c)(3) of the Internal Revenue Code

- Organizations that meet the requirements of section 501(c)(3) are exempt from federal income tax.
- A section 501(c)(3) organization must be operated exclusively for exempt purposes. An organization is considered to be operated exclusively for exempt purposes if it primarily engages in activities that accomplish exempt purposes.

Jeopardizing Exemption

- Private inurement and private benefit
- Political campaign activity
- Substantial lobbying
- Substantial unrelated business
- Failure to comply with reporting obligations

Private Inurement and Private Benefit

- Private inurement to insiders such as board members, officers, key employees, etc., is absolutely prohibited
- Private benefit is not limited to insiders and must be substantial to jeopardize exempt status

Intermediate Sanctions

- Alternative to revocation of exempt status
- Imposes penalty taxes on insiders and organization managers who engage in excess benefit transactions (e.g., payment of excessive executive compensation)

Lobbying Activities

- Attempting to influence legislation through:
 - Direct contact with members of a legislative body or their staff
 - Encouraging the public to contact members of a legislative body or their staff
 - Advocating a position on a public referendum

Limited Lobbying Is Permitted

- Measured by:
 - Substantial part test- all activities considered **OR**
 - Expenditure test
 - * Considers expenditures only
 - * Organization must elect it
 - * Churches cannot elect

Political Campaign Activity

- Direct and indirect candidate support:
 - Contributions
 - Participation in campaigns
 - Public statements for/against a particular candidate
- Absolutely prohibited

Acceptable Political Activities

- Leaders' personal statements but
 - No partisan comments in organization's publications or at official functions
 - Outside the organization, leaders should clearly indicate that comments are personal
- Candidate speeches if
 - Equal opportunity to all
 - Organization does not support or oppose
 - No political fundraising

Unrelated Business Income

- Three part test:
 - Trade or business activity
 - Regularly carried on
 - Not substantially related to the organization's exempt purpose
- An organization with substantial unrelated business activity is not operated exclusively for exempt purposes.

Filing Requirements

- Exempt organizations are generally required to file annual information returns (Form 990 or 990-EZ), although exceptions apply.
- If an organization does not file a required return or files late, penalties may be assessed.

Form 990-N (e-postcard)

- For tax years beginning after 12/31/06, organizations with gross receipts normally less than \$25,000 must file Form 990-N
- Can only be filed electronically
- Automatic revocation if not filed for 3 consecutive years

Hot Topics in 2007-2008

- Political Campaign Activity
 - IRS reminds charities and churches of political activity ban in 11/19/07 news release
 - IRS Revenue Ruling 2007-41 provides guidelines on the scope of the prohibition through hypotheticals
 - More enforcement?
- Draft redesigned 990
 - More detail required
 - Filing thresholds may be changed
 - To be used for the 2008 tax year (returns filed in 2009)

Hot Topics Cont.

- Governance
 - IRS posted a discussion draft of possible good governance practices for charitable organizations on its website on 2/7/07
 - “strongly recommends” that organizations consider adopting 9 recommendations (e.g., mission statement, code of ethics, document retention policy, etc.)